

Message Text

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ACTION EUR-25

INFO OCT-01 NEA-10 ISO-00 EURE-00 SS-20 DRC-01 RSC-01 /058 W

----- 116555

P R 291812Z NOV 73

FM AMEMBASSY LONDON

TO SECSTATE WASHDC PRIORITY 5934

INFO AMEMBASSY ANKARA

AMEMBASSY ATHENS

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

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FOR ASSISTANT SECRETARY STOESSEL FROM AMBASSADOR ANNENBERG

E.O. 11652: XGDS-1

TAGS: OVIP (KISSINGER, HENRY A.)

SUBJECT: EUROPEAN CHIEFS OF MISSION CONFERENCE -

SUPPLEMENTARY ASSESSMENT

REF: STATE 231853; LONDON 13892 AND 11643

1. THE ASSESSMENT OF US-UK RELATIONS WHICH WE PREPARED
ON OCTOBER 9 CONTINUES, IN MY JUDGMENT, TO BE VALID.
HOWEVER, THE MIDDLE EAST CRISIS AND ITS AFTERMATH, AND
PARTICULARLY THE INCREASING PRICE AND REDUCED SUPPLY OF
OIL ASSOCIATED WITH IT, HAVE HIGHLIGHTED BRITAIN'S
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DEPENDENCE ON MIDDLE EASTERN OIL AND CAST DOUBT ON THE

GOVERNMENT'S ABILITY TO ACHIEVE ONE OF ITS BASIC OBJECTIVES -- TO BREAK THE POST-WAR PATTERN OF STOP-GO ECONOMIC POLICY AND TO LAY THE BASIS OF SUSTAINED GROWTH. THIS MESSAGE SUMMARIZES THE EFFECT OF THE MIDDLE EAST CRISIS ON US-UK RELATIONS, OUTLINES THE ENERGY SITUATION, AND ASSESSES ITS IMPACT ON BRITAIN'S DOMESTIC AND INTERNATIONAL POSITION.

US-UK RELATIONS

2. THE MIDDLE EAST CRISIS AND ITS AFTERMATH PRODUCED STRAINS IN THE US-UK RELATIONSHIP WHICH HAVE BEEN AS EVIDENT AS THEY HAVE BEEN DEPLORABLE. FROM THE PERSPECTIVE OF LONDON THE CRISIS HAS HAD SEVERAL IMMEDIATELY IDENTIFIABLE POLITICAL CONSEQUENCES. (A) THE BRITISH HAVE REACTED WITH ACUTE SENSITIVITY TO US CRITICISMS OF THEIR ATTITUDE AND PERFORMANCE; THEY CONSIDERED OUR REBUKES UNJUSTIFIABLY HARSH AND LACKING IN RECOGNITION OF THE DIFFICULT POSITION IN WHICH BRITAIN FOUND ITSELF, ESPECIALLY WITH RESPECT TO CONTINUED ACCESS TO ARAB OIL ON WHICH THE COUNTRY'S INDUSTRIAL LIFE DEPENDS. THE BRITISH WERE SERIOUSLY DISTURBED ABOUT POSSIBLE LASTING EFFECTS OF THE CRISIS ON THE ALLIANCE AND, TO AN EXTENT, APPREHENSIVE THAT US DISENCHANTMENT WITH EUROPE COULD LEAD TO A LESSENING OF THE US COMMITMENT. IN THEIR OWN PUBLIC STATEMENTS THE BRITISH STUDIOUSLY AVOIDED COUNTER-CRITICISMS OF THE US, AND INSTEAD STRESSED THE CONTINUING IMPORTANCE OF NATO. (B) BRITISH ACTIONS AND POLICIES IN THE MIDDLE EAST CRISIS HAVE BEEN PARTIALLY RESPONSIBLE FOR THEIR EXCLUSION FROM AN IMMEDIATE PEACEKEEPING ROLE. AND THEY FEEL FRESH COMPULSION TO ENSURE THAT THEIR POSITION IN THE MIDDLE EAST IS SAFEGUARDED. HOWEVER LITTLE INFLUENCE ON CURRENT DEVELOPMENTS IN THE MIDDLE EAST THEIR POLICY HAS GAINED THE BRITISH, THEY REMAIN FIRMLY DETERMINED TO PROJECT A PRO-ARAB IMAGE. THE BRITISH HAVE TAKEN A LEADING PART AMONG THE EC NINE IN DEVELOPMENT OF COMMON APPROACHES, VIZ THE EC DECLARATION AND, APPARENTLY, THE SUBSEQUENT JOINT EC NINE DEMARCHE TO ARAB GOVERNMENTS SEEKING RELEASE OF MORE OIL TO WESTERN EUROPE. (C)

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CONCERN ABOUT THE MODEST INFLUENCE WESTERN EUROPE EXERCISES GENERALLY IN WORLD AFFAIRS AND WESTERN EUROPE'S APPARENT IMPOTENCE VIS-A-VIS THE UNITED STATES AND THE SOVIET UNION HAS GENERATED NEW IMPULSES IN THE UK TOWARD CLOSER HARMONIZATION OF WESTERN EUROPEAN FOREIGN POLICIES. SUCH CONCERNS HAVE LED TO INCREASED DISCUSSION OF THE POSSIBILITIES OF CLOSER WESTERN EUROPEAN DEFENSE COOPERATION. THERE IS HOWEVER NO FIRM

EVIDENCE AVAILABLE TO US HERE TO SUGGEST THAT AN INCREASE IN THE LEVEL AND INTENSITY OF DISCUSSION ON DEFENSE COOPERATION IS TAKING CONCRETE FORM. AT THE SAME TIME BRITISH UNEASINESS ABOUT THE PLACE OF BRITAIN (AND WESTERN EUROPE) IN WORLD AFFAIRS HAVE IN NO SENSE BEEN TRANSLATED INTO CHANGES OF DIRECTION OF BASIC BRITISH DEFENSE POLICY WHICH RESTS, AS ALWAYS, ON A STRONG NATO IN WHICH THE UNITED STATES REMAINS THE

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INFO OCT-01 NEA-10 ISO-00 SS-20 EURE-00 RSC-01 DRC-01 /058 W
----- 116404

P R 291812Z NOV 73

FM AMEMBASSY LONDON

TO SECSTATE WASHDC PRIORITY 5935

INFO AMEMBASSY ANKARA

AMEMBASSY ATHENS

AMEMBASSY BRUSSELS

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PARAMOUNT PARTNER.

3. THE MIDDLE EAST CRISIS HAS TENDED TO underscore TO THE BRITISH THE IMPORTANCE OF THINKING CAREFULLY BEFORE TAKING ACTIONS WHICH BLOCK THE UNITED STATES; EVEN IN THE MIDDLE EAST THIS SEEMS TO BE TRUE, DESPITE THE EC

NINE DECLARATION ON THE MIDDLE EAST AND BRITISH OBSESSION WITH THE OIL SHORTAGE. SPECIFICALLY, THEY ARE BEING VERY CIRCUMSPECT ABOUT INITIATIVES WHICH COULD COMPLICATE OUR PEACEMAKING RESPONSIBILITIES.

4. FINALLY, THE EVENTS OF THE PAST TWO MONTHS HAVE DEMONSTRATED THE NEED FOR AN INTENSIVE AND CONTINUING DIALOGUE BETWEEN THE UNITED STATES AND THE UNITED

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KINGDOM, PARTICULARLY IN AREAS WHERE THERE ARE OBVIOUS POLICY DIFFERENCES BASED ON DIVERGENT PERCEPTIONS. THE UNITED STATES SHOULD REFLECT ON THE NEED TO ENSURE THAT CONTACT EQUATES WITH COMMUNICATION; AND THAT EXPOSITION OF US POLICIES IS TIMELY, COMPREHENSIVE AND FRAMED WITH DUE REGARD TO STYLE AND TONE. WHILE THE UNITED STATES IS ENTITLED TO RECEIVE UNDERSTANDING FROM THE BRITISH AND OUR OTHER NATO ALLIES, IT IS ENCUMBENT ON US TO BE NO LESS PATIENT THAN WE ARE FIRM. THE ATLANTIC WORLD IS AS CENTRAL TO OUR WELL-BEING AS IT IS TO WESTERN EUROPE'S.

ENERGY AND THE UK'S INTERNATIONAL POSITION

5. SINCE THE OUTBREAK OF THE MIDDLE EAST WAR AND THE CUTBACKS IN OIL PRODUCTION BY THE ARAB PRODUCER STATES, BRITAIN HAS MAINTAINED AN EVEN MORE VISIBLY PRO-ARAB POSTURE THAN USUAL WITHIN THE UN AND THE EUROPEAN COMMUNITY. ITS EFFORTS HAVE BEEN REPAYED BY SOME SUCCESS IN KEEPING THE OIL FLOWING. AS A NATION CONSIDERED FRIENDLY TO THE ARABS, AT LEAST FOUR OF ITS FIVE IMPORTANT ARAB SUPPLIERS -- SAUDI ARABIA, KUWAIT, ABU DHABI AND QATAR -- HAVE ANNOUNCED THEY WILL CONTINUE TO SUPPLY BRITAIN AT THE LEVEL OF THE FIRST NINE MONTHS OF 1973. (NB THE ASSESSMENT IN THIS AND THE FOLLOWING PARAGRAPH WAS MADE WHILE DISCUSSIONS BETWEEN HMG AND THE ARAB OIL MINISTERS YAMANI AND ABDESSALEM WERE IN PROGRESS.) IN PRACTICE THIS MEANS THAT ALTHOUGH TWO-THIRDS OF BRITISH OIL IMPORTS COME FROM THE ARAB STATES, THE UK WILL SUFFER NO MORE THAN A 10 TO 15 PERCENT SHORTFALL IN CRUDE SUPPLIES, LARGELY AS A RESULT OF UNSATISFIED WINTER SEASON INCREASES IN DEMAND AND NORMAL ENERGY GROWTH REQUIREMENTS.

6. THERE IS POTENTIALLY A MORE SERIOUS SHORTFALL. BRITAIN ORDINARILY IMPORTS ABOUT 8 TO 10 PERCENT OF ITS PETROLEUM PRODUCT REQUIREMENTS FROM REFINERIES LOCATED AT ROTTERDAM. CONSEQUENTLY, UNLESS THE ARAB PRODUCERS AGREE TO SUPPLY EQUIVALENT AMOUNTS OF CRUDE OIL OR PRODUCTS DIRECTLY OR LIFT THEIR EMBARGO ON THE NETHERLANDS, AT LEAST SO FAR AS THE ROTTERDAM EXPORT MARKET IS CONCERNED,

THE SHORTFALL IN OIL SUPPLIES REACHING BRITAIN COULD

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AMOUNT TO 18 TO 25 PERCENT BY JANUARY 1974.

7. THE FIGURE FOR UK OIL "RESERVE STOCKS" ALREADY HAS FALLEN FROM 79 DAYS TO 64 DAYS AS TANKER LANDINGS HAVE DECREASED AND END USERS HAVE SOUGHT TO MAINTAIN MAXIMUM STOCKS. ALTHOUGH THE UK RECENTLY INSTITUTED A MANDATORY ALLOCATION PROCEDURE DESIGNED TO CUT OIL CONSUMPTION BY 10 PERCENT, FURTHER CUTS AND GAS RATIONING WILL HAVE TO BE INTRODUCED BY JANUARY UNLESS ARAB PRESSURES ARE DIMINISHED.

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INFO OCT-01 NEA-10 ISO-00 EURE-00 SS-20 DRC-01 RSC-01 /058 W
----- 116433

P R 291812Z NOV 73

FM AMEMBASSY LONDON

TO SECSTATE WASHDC PRIORITY 5936

INFO AMEMBASSY ANKARA

AMEMBASSY ATHENS

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8. ANOTHER ADVERSE FACTOR IN THE UK ENERGY PICTURE IS THE BAN ON OVERTIME WORK BY THE COAL MINERS UNION WHICH HAS REDUCED COAL OUTPUT BY 25 TO 30 PERCENT. IT WILL CAUSE TOTAL DEPLETION OF COAL STOCKS BY THE END OF DECEMBER IF THE MINERS' WAGE DISPUTE IS NOT SETTLED. COAL FURNISHES A VERY SUBSTANTIAL 35 PERCENT OF TOTAL UK ENERGY NEEDS, AS COMPARED WITH 50 PERCENT SUPPLIED BY PETROLEUM, AND THE MINERS ARE TAKING ADVANTAGE OF BRITAIN'S BADLY EXPOSED POSITION ON OIL SUPPLIES AND ARE PRESSING THE GOVERNMENT HARD TO DEAL WITH THEM ONCE AGAIN AS A SPECIAL CASE. SUCCESS IN THIS TACTIC COULD SPELL DEFEAT FOR THE AIMS OF THE GOVERNMENT'S PROGRAM TO CONTROL WAGE AND PRICE INFLATION.

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THE DOMESTIC ECONOMY

9. THE EFFECT OF THE ENERGY SHORTAGE ON THE BRITISH ECONOMY DEPENDS ON THE EXTENT OF THE CUTBACKS THAT WILL BE MADE IN OIL ALLOCATIONS, THE EFFICIENCY OF THE GOVERNMENT'S PRIORITY SYSTEM FOR OIL ALLOCATION, AND THE OUTCOME OF THE WAGE DISPUTE WITH THE COAL MINERS. AT ONE EXTREME IS A SCENARIO IN WHICH THE PRESENT 10 PERCENT CUTBACK IN OIL ALLOCATION IS SUFFICIENT, COAL PRODUCTION RESUMES WITHOUT AN INFLATIONARY WAGE SETTLEMENT, AND THE PRIORITY SYSTEM SUCCEEDS IN GETTING OIL TO IMPORTANT INDUSTRIAL USERS. BOTH THE UK TREASURY AND THE CONFEDERATION OF BRITISH INDUSTRY (CBI) NOW BELIEVE THAT SUCH AN OUTCOME WOULD MEAN THAT THE IMPACT ON THE GOVERNMENT'S GROWTH AND INFLATION POLICIES WOULD NOT BE SERIOUS. AT THE OTHER EXTREME IS A SCENARIO IN WHICH OIL CUTS RISE ABOVE 10 PERCENT, COAL PRODUCTION IS DISRUPTED, AND THE PRIORITY ALLOCATION SYSTEM IS NOT EFFICIENT. THIS WOULD IMPLY SEVERE ECONOMIC DISLOCATION; THERE COULD BE AN ABSOLUTE DECLINE IN INDUSTRIAL PRODUCTION AND GROSS DOMESTIC PRODUCT.

10. AN OUTCOME BETWEEN THESE TWO EXTREMES, WHERE REALITY PROBABLY LIES, IMPLIES SOME ADVERSE IMPACT ON INDUSTRIAL GROWTH AND ON THE GROWTH OF NATIONAL PRODUCT. SERIOUS REDUCTIONS IN INDUSTRIAL GROWTH WILL ADD TO THE INFLATIONARY PRESSURES AND FURTHER COMPLICATE THE GOVERNMENT'S DOMESTIC ECONOMIC POLICY. THIS HAS OBVIOUS

POLITICAL OVERTONES.

INTERNATIONAL ECONOMIC CONSIDERATIONS

11. THE BRITISH GOVERNMENT HAS OFFICIALLY ESTIMATED THAT THE INCREASED PRICE OF OIL WILL ADD ROUGHLY A BILLION DOLLARS TO THE UK'S IMPORT BILL OVER THE COURSE OF THE NEXT YEAR. IT HOPES THAT ADDITIONAL UK EXPORTS TO ARAB COUNTRIES WILL REDUCE THE IMPACT. THE EMBASSY IS LESS OPTIMISTIC. ASSUMING NO ADDITIONAL PRICE INCREASES FOR OIL, THE IMPORT COST TO THE UK COULD BE IN THE AREA OF 1.3 BILLION DOLLARS. THE ECONOMY IS OPERATING AT

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NEARLY FULL CAPACITY. IT IS HARD TO SEE ANY SIGNIFICANT SCOPE FOR ADDED EXPORTS, AT LEAST IN THE SHORT RUN. THIS VIEW IS SHARED PRIVATELY BY SOME TOP UK INDUSTRIAL LEADERS.

12. AS THE ARABS INCREASE THEIR OIL REVENUES, THE MAIN OUTLETS FOR INVESTMENT OF THE FUNDS APPEAR TO BE IN THE DOLLAR, STERLING AND EUROCURRENCY MARKETS. THE UK WILL TRY TO PROMOTE ADDITIONAL ARAB INVESTMENT IN STERLING AND THROUGH THE FINANCIAL FACILITIES OF THE CITY OF LONDON. THE GOVERNOR OF THE BANK OF ENGLAND HAS JUST RETURNED FROM A TRIP TO SAUDI ARABIA WHERE THIS OBJECTIVE FIGURED IN HIS CONVERSATIONS.

13. ON A LARGER SCALE, THE UK IS CONCERNED THAT MAJOR INDUSTRIALIZED COUNTRIES MAY ATTEMPT TO EARN INCREASED TRADE SURPLUSES FROM EACH OTHER TO OBTAIN THE ADDITIONAL FOREIGN EXCHANGE NECESSARY TO MEET THE INCREASED COSTS OF ARAB OIL. UK FINANCIAL OFFICIALS WOULD PREFER THAT THE MAJOR INDUSTRIALIZED COUNTRIES ACCEPT THAT THEY WILL HAVE INCREASED TRADE DEFICITS, WHICH CAN LIKELY BE FINANCED BY ADDITIONAL CAPITAL FLOWS AS THE ARAB COUNTRIES RECYCLE THEIR INCREASED EARNINGS.

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Message Attributes

Automatic Decaptoning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: n/a
Control Number: n/a
Copy: SINGLE
Draft Date: 29 NOV 1973
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: worrelsw
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1973LONDON13970
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: X1
Errors: N/A
Film Number: n/a
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1973/newtext/t1973116/aaaaadtg.tel
Line Count: 374
Locator: TEXT ON-LINE
Office: ACTION EUR
Original Classification: SECRET
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 7
Previous Channel Indicators:
Previous Classification: SECRET
Previous Handling Restrictions: n/a
Reference: STATE 231853; LONDON 13892 AND 11643
Review Action: RELEASED, APPROVED
Review Authority: worrelsw
Review Comment: n/a
Review Content Flags:
Review Date: 31 JUL 2001
Review Event:
Review Exemptions: n/a
Review History: RELEASED <31-Jul-2001 by maustmc>; APPROVED <21-Aug-2001 by worrelsw>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: EUROPEAN CHIEFS OF MISSION CONFERENCE - SUPPLEMENTARY ASSESSMENT
TAGS: OVIP, (KISSINGER, HENRY A)
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005